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INFO RUEHZM/GULF COOPERATION COUNCIL COLLECTIVE PRIORITY
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C O N F I D E N T I A L SECTION 01 OF 02 MANAMA 000002

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BAGHDAD FOR AMBASSADOR ERELI

E.O. 12958: DECL: 01/04/2019
TAGS: ECON EFIN PGOV BA
SUBJECT: BAHRAIN'S BUDGET SQUEEZE

REF: 08 MANAMA 774

Classified By: CDA Christopher Henzel for reasons 1.4 (b) and (d)

¶1. (C) Summary: Following a sharp decline in oil prices, the GOB is decreasing its budget projections by more than 50%, but will likely need to resort to deficit financing anyway. In the face of raised expectations from last year's record oil prices, significant reductions in promised public projects may feed public dissatisfaction. End Summary.

¶2. (C) Background: Bahrain's budget is prepared biannually and projections are largely based on the projected price of oil. Although oil is not the leading contributor to Bahrain's GDP, it accounts for almost 75% of government revenues. Bahrain refines all of its oil through its own Bahrain Petroleum Company (BAPCO), and is not an exporter of crude oil. Since 2005, BAPCO has refined an average of 265,000 bbl/day, or approximately 98 million barrels of oil per year. According to BAPCO CEO Abdulrahim Al Sayed, BAPCO purchases its crude feedstock from the Bahraini National Oil and Gas Authority (NOGA) at a price about seven dollars below the prevailing world "Brent" price. The government uses this NOGA price for its budget projections.

¶3. (C) The GOB based its 2007/2008 budget on estimates that the NOGA oil price would be $40/bbl. In fact the price averaged $65/bbl in 2007, and almost $92/bbl in 2008. This differential allowed the government to easily beat expectations and bank significant surpluses. As oil prices increased dramatically in 2008, there was political pressure to increase government spending, particularly on public works projects. The 2008/2009 draft budget delivered to Parliament in October 2008 was based on a projected oil price of $65/bbl)- which would have increased government spending by almost 60%. In November, following the plunge in oil prices below $60/bbl, the budget was returned to the Cabinet to be recalculated. Ministry of Finance Assistant Undersecretary Yousif Humood told EconOff on December 29 that the Cabinet's re-drafted budget is based on an estimated price of $40/bbl, despite pressure from Parliament to set it no lower than $45/bbl. "Brent" crude is currently trading at approximately $46/bbl, or a NOGA equivalent of about $39/bbl, slightly below the revised budget calculations. End Background.

¶4. (C) In a December 11 meeting, Minister of Commerce and Industry Hassan Fakhro told the Ambassador that the drop in oil prices had effectively killed all plans for new public works projects and that even if prices return to $40/bbl, the government would need between $200 and 400 million in deficit financing next year to continue public works projects already underway. He further stated that work on the 15,000 unit (75,000 person) public housing project known as "Northern City", already more than two years behind schedule, will slow even more. The Northern City project was originally promoted as a benefit to the (primarily Shi'a) underclass of the

Northern Governorate and remains a sensitive issue for Shi'a/Wifaq (reftel).

¶5. (C) On December 25, the Parliament Committee on Finance and Economy held an emergency session to review the proposed budget in light of decreasing oil prices. The committee's deputy chairman, Abdulraheem Murad (a member of the Sunni Al Asala bloc), told the press that their primary concern was to salvage the budgets of housing, health, and education. MOF Assistant U/S Humood told EconOff that the Finance Minister has directed all ministries to make permanent reductions in their operating budgets. The Civil Service Bureau has ordered a hiring freeze.

¶6. (C) Comment: Historically, the GOB has intentionally underestimated the price for oil in budget preparations, allowing it to have significant discretionary spending power while still posting modest surpluses. As oil prices have dropped, each dollar decrease in price equates to a decrease of almost $100 million in government revenue. If 2009 government spending remains steady at 2008 rates (with inflation running between 6-8%) and if the price for "Brent" drops again to around $40/bbl, the 2009 budget deficit may not be $200-400 million as the Minister of Finance predicted, but closer to $1 billion, or almost 5% of GDP.

¶7. (C) With 2008 oil prices averaging $92/bbl, and a budget originally calculated using an oil price of $40/bbl, the government could post a surplus of almost $4 billion for
¶2008. (Note: Bahrain has never posted a government surplus or deficit of more than $210 million. There has been no discussion of the government posting a surplus in 2008. End

note.) As promised public works projects are taken off the board, and even existing spending is constrained, oppositionists are likely to sharpen their criticism of the government and question why 2008 surpluses cannot be used in 2009 to meet promises already made. Asking the largely Shi'a underclass to be patient, or even tighten their belts following a year of record profits is not likely to be a winning proposition. End comment.

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